

‘Trading the gap’ give insiders a big advantage in stock trades. And it’s perfectly legal.

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Stock markets today move by the microsecond. Fortunes are made and lost in the blink of an eye. Yet public companies are still allowed to wait four business days before announcing a major merger, bankruptcy, layoff or a new CEO. That kind of news can send share prices soaring or crashing. And a potential 96-hour delay in revealing those events translates into an eon by the clock that runs modern markets.

It also gives a huge advantage to corporate insiders, who are often permitted to buy and sell shares based on the important news before other investors even find out what happened, [according to a new paper](#) by Columbia and Harvard researchers.

It’s called “trading the gap.” And in the past six years, corporate insiders have earned \$105 million in above-market profits by doing it, researchers found.

It’s not illegal. But the findings raise questions about whether this was the intended effect of financial regulations, write study authors Alma Cohen of Harvard Law and Robert J. Jackson, Jr. and Joshua R. Mitts at Columbia Law.

The Securities and Exchange Commission expressly allows companies to take up to four days to announce what are called “material events.” These events are listed on 8-K forms, which are published on the SEC Web site and quickly digested into share prices on stock exchanges.

In 2002, the SEC proposed shortening the 8-K delay to two business days from five days – or even 15 calendar days in certain situations. But lobbying by the financial industry caused regulators to pull back. The SEC went instead with a universal four-day wait.

Many firms disclose material events to the public right away. They are not required to wait. But each year, more than 3,000 firms take full advantage of SEC rules, the study found.

The study authors offered some suggestions. Lawmakers need to be mindful of insider trading when designing new disclosure rules. And firms might want to consider prohibitions on insiders “trading the gap” to avoid potential litigation. Such trading blackouts are not uncommon, often seen in connection to quarterly profit statements.